DMA Report and Accounts

Period from 15 November 1999 to 31 March 2001

Presented to Parliament in Pursuance of
Schedule 5A of the National Loans Act 1968
(as amended by the Finance Act 1998).

Ordered by the House of Commons
to be printed on 19th December 2001.

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Foreword

Background

The UK Debt Management Office (DMO) was established on 1 April 1998. Its aim is "to carry out the Government's debt management policy of minimising financing costs over the longer term, taking account of risk, and to manage the aggregate cash needs of the Exchequer in the most cost effective way".

The establishment of the DMO followed the announcement by the Chancellor of the Exchequer on 6 May 1997 that responsibility for setting of official interest rates was being transferred from HM Treasury to the Bank of England. As a corollary of this he also announced that the Bank of England's role as the Government's agent for debt and cash management was being transferred to HM Treasury. The objectives were to ensure that debt management decisions could not be influenced by, or thought to be influenced by, inside information on interest rate decisions, and to increase transparency in debt and cash management operations.

The DMO assumed responsibility for debt management on 1 April 1998 and for cash management on 3 April 2000.

The DMO's Objectives

HM Treasury Ministers set the DMO's strategic objectives, which are published in the DMO's Business Plan and its Framework Document[1]. The current 12 strategic objectives are:

1. To meet the annual remit set by Treasury Ministers for the sale and purchase of gilts, with high regard to long term cost minimisation, taking account of risk.

2. To offset, through its market operations, the expected outturn cash flow into or out of the National Loans Fund (NLF), on every business day, and in a cost-effective manner with due regard for credit risk management.

3. To manage effectively, in accordance with objectives set by Treasury Ministers, any assets held on the Debt Management Account.

4. To advise Ministers on setting the remit to meet the Government's objectives under 1-3 above; and to report to Ministers on the DMO's performance against its remit, objectives and targets.

5. To develop policy on and promote advances in new instruments, issuance techniques and structural changes to the debt and Treasury bill markets that may help to enhance the efficiency and lower the cost of debt and cash management, liaising as appropriate with the relevant bodies; to keep abreast of developments in debt and cash management policy and practice; and to provide policy advice to Treasury Ministers and officials accordingly.

6. To conduct its market operations, liaising as necessary with the relevant bodies, with a view to maintaining or promoting an orderly, efficient and liquid market for gilts.

7. To provide, including in liaison with the Bank of England and CRESTCo, a high quality and efficient service to investors in Government debt, and to deal fairly and professionally with market participants in the gilt and money markets, consistent with achieving low cost issuance and an efficient market.

8. To contribute to the Treasury's work on the development of the strategy for managing the Government's financial assets and liabilities.

9. To make information publicly available on the debt and Treasury bill markets and DMO policies where that contributes through openness and predictability to efficient markets and lower costs of issuance.

1 The latest versions of these documents are available on the DMO's website www.dmo.gov.uk:
– *Business plan 2001-02* published 9 April 2001
– *Framework document* published 18 July 2001

10. To provide advice and expertise to other Government departments (and other governments) as required, and consistently with meeting the objectives 1-3 above.

11. To resource, staff and manage the Office to deliver its objectives effectively and efficiently and to ensure value for money in its administrative expenditure.

12. To develop appropriate management, information and control systems with high regard to risk minimisation; and to ensure full and accurate presentation of accounting and other information.

Purpose of the Debt Management Account (DMA)

The Finance Act 1998 provided for the establishment of the Debt Management Account (DMA) and this was created by order on 15th November 1999. Its purpose is the management and reporting of the debt and cash dealing operations that the DMO undertakes to meet its objectives.

As the Government's debt manager, a key role of the DMO is as an issuer of gilt-edged securities, and additionally it supports the secondary market. (Gilt-edged securities, or gilts, are UK Government sterling denominated listed securities with longer-term maturities issued by HM Treasury.) Prior to the establishment of the DMO, secondary market gilt activities were the responsibility of the Bank of England acting as agent of HM Treasury. Purchases and sales were transacted through the "Gilt-Edged Official Operations Account" (GOOA) which was set up in 1993 to act as a warehousing account for gilts. The GOOA was the responsibility of the National Investment and Loans Office.

When the DMO assumed responsibility for debt management from the Bank of England, the Government was able to set up a new account to replace the GOOA. The remaining holdings of the GOOA were sold to the DMA; the GOOA has now been closed and its final accounts have been presented to Parliament.

These accounts are the first accounts published for the DMA and cover a period of sixteen and a half months (from 15th November 1999 to 31st March 2001). Future accounts will be produced on an annual basis. Only the DMO's market transactions are accounted for through the Debt Management Account. Reported separately from the DMA, the DMO's administrative income and expenditure for the period to 31 March 2001 was published in the DMO's Annual Report & Accounts 2000-01 and presented before Parliament on 18th July 2001. This document is available on the DMO's web site at www.dmo.gov.uk.

Guide to the DMA and Relationship to the National Loans Fund

The operations of the Consolidated Fund and the National Loans Fund (NLF) – the two key central government funds – are central to an understanding of the accounting arrangements for government debt and cash management, and the role of the DMA. The Consolidated Fund accounts for most central government expenditure and receipts, except for borrowing and financing transactions that are accounted for by the NLF and the DMA. The NLF is the government's main borrowing account. It also funds some government lending, particularly to local authorities via the Public Works Loan Board. The NLF balances the Consolidated Fund at the end of each day.

Essentially the DMA's role is to meet the financing needs of the NLF, both in terms of long-term (debt management) and short-term requirements and to meet the NLF's day-to-day cash needs (cash management of both surplus and deficit cash positions). All lending by the DMA to the market when the government has excess cash is an asset of the DMA, while DMA borrowing from the market is a liability. Day-to-day borrowing and lending largely takes the form of the issuance of Treasury bills and repo and reverse repo transactions with the DMO's commercial counterparties. These latter transactions are collateralised, usually using gilts. For this purpose the DMA holds a large gilt portfolio, a significant proportion of which was bought from the National Investments and Loans Office (NILO) early in the life of the DMA to underpin the DMO's cash management operations.

The Debt Management Office undertakes gilt issuance operations via the DMA on behalf of the NLF. The NLF creates the gilt which is to be issued and sells it to the DMA from where it is sold on to the market. The responsibility for paying gilt coupons and redeeming debt on maturity falls to the NLF, as gilts remain the liability of the NLF. The DMA also periodically undertakes secondary market gilt transactions in relatively small volumes.

Treasury bills are issued by, and are the liabilities of, the DMA as part of its cash management operations.

To fund the DMO's market operations, the NLF made a cash advance to the DMA at its inception. Further cash advances to the DMA have been made over the first accounting period to fund the DMA's activities as they have broadened. The advance stood at £35 billion on 31st March 2001. At the end of each day, the remaining balance of the advance (less a target Bank of England balance of £200 million) is returned to the NLF as a deposit and this is the means by which the DMA balances the daily financing needs of the NLF. On 31st March this deposit was £22.5 billion. The DMA is charged interest on the advance by the NLF at a rate equal to the Bank of England repo rate. The DMA earns interest at the same rate on any daily deposit made with the NLF.

The need to extend the advance is also driven by a requirement of the Finance Act 1998, which places a cap on the borrowing of the DMA, other than from the NLF. This requires that market borrowing by the DMA (principal outstanding of any money raised, excluding money raised from the NLF) should never exceed its deposits with the Bank of England and the NLF.

Operating surpluses and deficits made annually by the DMA are an asset or liability of the NLF respectively. All or part of any DMA surplus created may be paid to the NLF, which will accordingly reduce the liability of the DMA to the NLF. If there was a cessation of the DMA with a corresponding liquidation of all balances, the NLF is entitled to the net amount realised. In such a situation the NLF will have a responsibility to meet outstanding liabilities including those relating to Treasury bills issued by the DMA.

Review of Operations

Operating Results for the Period

The DMO successfully achieved it objectives for the sale of gilts specified in the annual remit set by Treasury Ministers. It also successfully achieved its objective to offset through its market operations, the expected net cash flow into or out of the NLF, on every business day, and in a cost-effective manner.

Further information on the DMO's achievements against its strategic objectives can be found in the DMO's Annual Report and Accounts 2001-2002 and its Business Plans for 2000-2001 and 2001-2002, all of which can be found on its web site at www.dmo.gov.uk.

The DMA's operations in the period 15th November 1999 to 31st March 2001 gave rise to net interest income of £87 million and valuation gains on market transactions and assets held of £77 million, producing a surplus of £164 million.

The DMO's operations as both the Government's debt manager and its cash manager take place within a policy framework that underpins the DMO's strategic objectives and an annual remit laid down by the Chancellor of the Exchequer. As far as cash management operations are concerned, although the DMO seeks to conduct its market interactions cost effectively, it also has to take into account the primary requirement to smooth the Exchequer's cash flows and to balance the NLF daily. In some circumstances this may reduce the range of available trading strategies that would be open to a commercially driven body.

There are likely to be a range of influences on the DMA's operating results in any accounting period. The size and composition of the DMA's balance sheet during the year and the maturity of the DMO's money market transactions will inevitably reflect the pattern of Government cash flows, rather than any trading view by the DMO. The DMA's net operating results will therefore be heavily influenced by the interaction between transactions undertaken by the DMO to smooth Government cash flows and market conditions over the course of the year. Similarly any valuation gains or losses are likely in large part to reflect the impact of external interest rate movements on the mark to market value of the DMO's holdings of gilt-edged securities which are predominantly, although not exclusively, held as collateral for the DMO's cash management operations.

According to the terms of the Finance Act 1998, the DMA's operating surplus is a liability of the DMA to the National Loans Fund. All or any part of this surplus may be paid from the DMA to the NLF at a time agreed as appropriate, thereby reducing or negating the liability accordingly. However, there is no requirement for a payment to be made annually and as at the date of publication no such payment had occurred.

The DMO has a statutory requirement to maintain the value of its liabilities in the market at a value lower than its cash and cash equivalents; that is, the sum of its operating bank balance at the Bank of England and its over-night deposit with the National Loans Fund. This has been monitored over the accounting period and successfully achieved. At the balance sheet date, cash and cash equivalents in the DMA exceeded market liabilities by £11.9 billion.

Structure and policy on operations

The DMO is legally and constitutionally part of HM Treasury, but as an Executive Agency, it operates at arms-length from Ministers. The Chancellor of the Exchequer determines the policy and operational framework within which the DMO operates, but delegates to the Chief Executive operational decisions on debt and cash management, and day-to-day management of the office.

The DMO receives annual remits from HM Treasury covering both its debt and cash management operations. The remits are published in the Debt and Reserves Management Report, usually issued as part of the Budget announcements each Spring. The DMO conducts its operations for the forthcoming financial year within the scope of these remits, and to meet its specified objectives and targets.

The gilts remit specifies the planned annual total of gilt sales in cash terms, the split between conventional and index-linked gilt sales and within conventional gilts the split by maturity band. The dates of scheduled outright auctions are also announced. The remit would also provide the basis for the conduct of any switch, conversion or buy-back operations in a particular year. The cash remit provides information on the planned scale of Treasury bill issuance and by maturity. The remit is expressed in terms of a planned stock of Treasury bills at the end of the financial year.

Within the framework of the remits the DMO decides the size of gilt auctions and Treasury bill tenders and choice of gilts being auctioned.

The DMO publishes Operational Notices describing how it will act in the gilts and sterling money markets – copies of these documents are available on the DMO web site at www.dmo.gov.uk

Review of operations and dynamics of the DMO's business

Upon taking responsibility for cash management on 3rd April 2000, the DMO's main challenge in 2000-01 was the management of a steadily rising and sizeable Government cash surplus. The cash surplus was forecast at £4.9 billion in the 2000 Budget, whereas the outturn was £35.2 billion.

The debt remit identified a number of contingencies for meeting a larger Government cash surplus. These were triggered early in the financial year after a larger than forecast surplus for 1999-2000 and the proceeds received from the auction of third generation mobile phone licences. A gilt auction was cancelled, but the DMO's revised remit maintained a minimum level of cash to be raised by gilt auctions at £10 billion – which was achieved. This recognised the importance to the Government of sustaining gilt market liquidity and investor interest in the light of the forecast increase in the financing requirement over the next few years. One implication was an increase in the year in the Government's short-term cash position. This position is managed by the DMO against a benchmark, and the DMO's performance is reported to HM Treasury. The cash position is expected to be run down over the next three financial years (i.e. by end March 2004). The anticipated run down will, all other things being equal, smooth the future gilt issuance needs of the Government.

The DMO initially planned to use Treasury bills, repo and reverse repo transactions and, to some extent, short maturity bonds, bank lending and bank deposits for short-term cash management. The size of the surplus in 2000-01 reduced the scope (and need) for the issuance of Treasury bills. However, in the course of the year, the DMO expanded the range of instruments used in its cash management operations, adding Certificates of Deposit and sterling Commercial Paper to its portfolio of short-term holdings.

Developments subsequent to 31st March 2001

The DMO announced on 9 November 2000 that it could use short-term foreign currency swaps, Forward Rate Agreements (FRAs), and interest rate futures to manage foreign currency and interest rate exposures. Any foreign currency exposures would be fully hedged back into sterling. The first of these kinds of transaction occurred in May 2001.

Risk Management

DMO's Approach to Managing Risk

The DMO attaches a high priority to Risk Management. It has developed a set of policies to limit its exposure to risk in the achievement of its objectives. The DMO's position differs from that of a commercial organisation in that it must always be in a position to transact the underlying business required to meet its remit, although it will seek to minimise risk in doing so. Implementation of these policies is the responsibility of the Chief Executive as the Accounting Officer of the DMA. In this role he is assisted by functional teams and committees composed of members with the necessary experience and expertise to consider and evaluate the risks in question.

The main committees are:

Credit and Risk Committee

The committee defines the DMA's approach to the management of risk by setting policies that maintain a balance between risk appetite and business requirements. The remit of the DMO Credit and Risk Committee includes assessment of a broad range of risk areas.

Audit Committee

Chaired by a non-executive director, this committee meets on a quarterly basis to review the adequacy of the DMO's management of risk and internal controls. It also reviews the internal audit programme and examines completed internal and external audit reports. It considers their major findings and ensures that recommendations are implemented where necessary. The Audit Committee also considers whether management has established adequate arrangements to comply with regulatory and financial reporting requirements, and operational best practices where appropriate. To this end the Audit Committee also examines completed compliance monitoring reports.

Managing Committee

This committee meets weekly to consider strategic and operational issues, taking advice as necessary from an Advisory Board composed of senior managers and non-executive directors. The Committee periodically reviews the DMO's strategic and operational risks, along with the policies for their effective management. Heads of business units report regularly to the Managing Committee on risk management issues in their areas.

Responsibility for day-to-day control is delegated to the business units to ensure that good risk management practices are embedded throughout the business. The business units are supported by a number of functions that ensure that senior managers and the DMO's key operational committees have appropriate information to fully understand the risks concerned; and to demonstrate that they are properly measured and prudently managed.

The main functions in this context are:

Risk Management Unit

This unit provides a capability for the management of market and credit risk, and its reporting; and also for preparation of legal agreements with counterparties.

Internal Audit Function

This function provides a full internal audit service including control systems advice as required, and audit reports on the adequacy and effectiveness of the DMO's internal controls and where applicable recommendations for improvement.

Compliance Function

This function reviews key operations to assess the extent of compliance with plans, policies, procedures and legislation. The compliance reviews in the period have been focussed on scheduled debt and cash management operations, in particular Treasury bill tenders and gilt auctions.

Further details of the DMO's risk management processes are given in the Statement on Internal Control on page 14.

Objectives and Policies for Holding and Issuing Financial Instruments

Debt Management Operations

"to carry out the Government's debt management policy of minimising financing costs over the longer term, taking account of risk"

As the Government's debt manager, a key role of the DMO is as an issuer of gilt-edged securities. Gilts are issued on behalf of the Government. Although they are issued by the DMO, thereby passing through the DMA, they remain a liability of the NLF.

In its aim to reduce financing costs over the longer run, the Government seeks to minimise the net present value of its debt rather than the debt interest bill in the current year. The long-term nature of many debt instruments and the importance of an issuer's relationship with the debt markets requires the Government to take debt management decisions with a longer term perspective.

The reference to risk in the Government's debt management policy means that it tries not only to choose a strategy that minimises the expected average debt cost over the longer term, but tries also to ensure that the chosen one is robust against different economic outturns.

The main way in which the Government influences the composition of its debt portfolio is through the strategy of new issuance that it adopts each year. This sets the proportions of index-linked and conventional gilts and the pattern of issuance across different maturities.

Except where there is a clear institutional preference, the Government is rarely in a position to know for certain that issuing one sort of gilt will prove cheaper than another. Therefore, the preferred strategy is to structure new issuance so that the debt portfolio will not expose Government to sharp fluctuations in its financing requirement and debt servicing costs under a range of possible economic outturns. As a consequence the portfolio has a mix of conventional and index-linked debt, as well as a diversity of maturities.

DMO advises HM Treasury to assist in its selection of an appropriate debt issuance strategy in its annual remit.

In addition to issuance, the DMO undertakes gilt transactions in the secondary market with the Gilt Edged Market Makers (GEMMs). Under an agreement with the DMO, the GEMMs provide a secondary market in all gilts and are the primary point of access for investors to the DMO's gilt auctions.

Cash Management Operations

"to manage the aggregate cash needs of the Exchequer in the most cost effective way"

The cash management remit set by HM Treasury specifies that the DMO's main objective in cash management is to offset, through its market operations, the expected cash flow into or out of the NLF on every business day. It is to do this in a cost-effective way balancing cost and risk in its strategies and without influencing the level of short-term interest rates.

The remit specifies that the DMO is to carry out its cash management objectives primarily by a combination of the following activities:

- Regular weekly Treasury bill tenders;
- Bilateral dealing with DMO counterparties;
- Ad hoc tenders of Treasury bills (and repo or reverse repo transactions).

To date DMO has principally used the Treasury bill and secured markets to effect both long- and short-term Exchequer cash operations.

Over the course of the reporting period the DMO expanded the range of financial instruments, adding Certificates of Deposit and sterling Commercial Paper to its portfolio of short-term holdings.

Specific Risks

Market Risk: Management of market risk by the DMO takes account of the underlying objective for acquiring or holding the asset or liability position. The DMO is exposed to fluctuations in the market price of its holdings of securities over the short term. However, the DMO intends to hold to maturity, or over the long term, most of its holdings of securities. Where this is the case the DMO attaches a relatively low priority to containing this risk in the short-term where to do so would incur hedging costs. In other cases, the DMO's risk strategy takes account of the fact that some risk management actions may be inconsistent with the DMO's underlying objective, such as for example the promotion of an efficient and liquid market.

In addition, significant losses will generally not be realised as a result of the DMO's dealing operations. This is because – as required under the statutory terms of its establishment – the DMA operates with a large proportion of its balance sheet assets represented by an over-night deposit with the NLF, thereby greatly reducing liquidity risk. Additionally, the risk of the DMA being unable to meet its liabilities as they fall due is strongly mitigated by the relationship between the DMA and the NLF, which allows at short notice for a further advance from the NLF to be drawn as operational activities require.

The DMO calculates interest rate sensitivity measures across its entire portfolio of financial instruments. In addition it regularly scenario tests relevant parts of the portfolio. The DMO is currently developing its capability to apply a wider range of measures and analysis, including value at risk techniques.

The interest rate profile of all DMA assets and liabilities on 31st March 2001 is stated in the table below. (Items are allocated to time bands by reference to the earlier of the next interest rate repricing date and maturity date. Note that, for completeness, accrual items have been included in the analysis by reference to the next cash flow stemming from the asset or liability to which they relate.)

Interest Rate Profile

As at 31 March 2001	**0-3 months £m**	**3-6 months £m**	**6-9 months £m**	**9-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Non rate items £m**	**Total £m**
Assets								
Cash Balance at Bank of England	446	-	-	-	-	-	-	446
Items in the course of collection from other banks	597	-	-	-	-	-	-	597
Loans and advances to banks	10,988	1,601	-	-	-	-	-	12,589
Debt securities	2,732	1,033	1,038	-	1,750	3,413	-	9,966
Other assets: prepayments and accrued income	419	41	-	-	-	-	-	460
	15,182	**2,675**	**1,038**	**–**	**1,750**	**3,413**	**–**	**24,058**
Liabilities								
Items in the course of transmission to banks	120	-	-	-	-	-	-	120
Deposits by banks	3,013	-	-	-	-	-	-	3,013
Debt securities in issue	8,096	-	-	-	-	-	-	8,096
Other liabilities: accruals and deferred income	224	-	-	-	-	-	-	224
National Loans Fund - net financing	12,441	-	-	-	-	-	-	12,441
National Loans Fund - DMA surplus	-	-	-	-	-	-	164	164
	23,894	**-**	**-**	**-**	**-**	**-**	**164**	**24,058**
Interest rate sensitivity gap	(8,712)	2,675	1,038	-	1,750	3,413	(164)	

	0-3 months	**0-6 months**	**0-9 months**	**0-12 months**	**0-5 years**	**All periods**	**All items**
Cumulative gap (£m)	(8,712)	(6,037)	(4,999)	(4,999)	(3,249)	164	-

Active markets exist for the debt securities in the chart (gilts, Treasury bills, Certificates of Deposit and Commercial Paper) except for a small proportion of the DMO's gilt holdings represented by "rump" stocks. Rumps are specific gilts in which the DMO will be prepared to make a price if requested, but in which, because of the small nominal value outstanding, GEMMs are not required to make a market.

Foreign Currencies: The DMA held no foreign currency investments during the accounting period. Euro-denominated government and supranational bonds were used as collateral for a significant proportion of the reverse repo lending to counterparties in the accounting period. The DMO's daily collateral margining operations include management of exposures resulting from changes in euro-sterling exchange rates.

Derivatives and Hedging: No derivative or hedging trades were undertaken in the financial period.

Accounting policies

The accounts of the DMA for the period are drawn up on a UK GAAP basis as far as appropriate, to reflect best accounting practice in reporting on the DMA's activities. The accounts primarily reflect the results of transactions in activities that are carried out in ways and for purposes (though without an overall aim to make a profit) that make them comparable to those of a banking entity.

Accordingly, accounting requirements for banking entities form the basis of the DMA's Accounts Direction (page 29) and are reflected in its accounting policies (page 21). The effect is that, for example, securities held for trading purposes are marked to market and the related unrealised gains and losses are recognised as income and expenditure in the period.

Preparation of the Accounts

The accounts have been prepared in accordance with a direction given by HM Treasury in pursuance of Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998). The text of the direction is reproduced on page 29 of this document. The accounts and supporting notes relating to the Debt Management Account for the period from 15 November 1999 to 31 March 2001 have been audited by the Comptroller and Auditor General.

MIKE WILLIAMS
Chief Executive and DMA Accounting Officer
12 December 2001

Statement of Accounting Officer's Responsibilities

Under Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998) the Treasury has directed the DMO to prepare a statement of the Debt Management Account for each financial period in the form and on the basis set out in the accounts direction on page 29 of these financial statements. The accounts are prepared on an accruals basis and must give a true and fair view of the operations of the Debt Management Account at the year-end and of its income and expenditure, total recognised gains and losses and cash flows for the financial year.

In preparing accounts the agency is required to:

- *observe the accounts direction issued by the Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;*

- *make judgements and estimates on a reasonable basis;*

- *state whether applicable accounting standards have been followed, and disclose and explain any material departures in the financial statements;*

- *prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the account will continue in operation.*

The Accounting Officer of HM Treasury has designated the Chief Executive of the Debt Management Office as the Accounting Officer for the Debt Management Account. His relevant responsibilities as Accounting Officer, including his responsibility for the propriety and regularity of the public finances and for the keeping of proper records, are set out in the Accounting Officers' Memorandum, issued by the Treasury and published in "Government Accounting".

MIKE WILLIAMS
Chief Executive and DMA Accounting Officer
12 December 2001

Statement on Internal Control

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the UK Debt Management Office's targets, policies and objectives set by Treasury Ministers, whilst safeguarding the public funds and agency's assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

The system of internal control is designed to manage rather than eliminate the risk of failure to achieve targets, policies and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.

The system of internal control is based on an ongoing process designed to identify the principal risks to the achievement of the Office's targets, policies and objectives, to evaluate the nature of and extent of those risks and to manage them efficiently, effectively and economically. This process, which is continuing to develop, has been operational from October 2000 and accords with Treasury guidance.

As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. The Office has established the following processes:

1. A robust corporate governance management structure comprising:

    - *An Advisory Board which meets monthly to consider the plans and strategic direction of the DMO;*
    - *A Managing Committee which meets weekly to consider strategic and operational issues, referring key issues to the Advisory Board where necessary;*
    - C*ash Strategy, Debt Strategy, Investment, and Credit and Risk Committees;*
    - *An Audit Committee, chaired by a non-executive director, which meets on a quarterly basis to review the adequacy of the DMO's management of risk and internal controls.*

2. An internal audit function complying with the standards of the Government Internal Audit Manual. Audit reports are produced providing an opinion on the adequacy and effectiveness of the DMO's internal control systems and where applicable contain recommendations for improvement.

3. A compliance function that reviews key operations to assess the extent of compliance with plans, policies, procedures, and legislation. The compliance reviews have been focussed on set-piece debt and cash management operations although the scope will be increased during 2001–2.

4. An organisation-wide risk register has been produced following an assessment by Managing Committee of the Office's strategic and key operational risks. This has facilitated regular assessment of the adequacy and effectiveness of controls used to manage these risks. Risk workshops will also be held with staff to help ensure that all key operational risks have been identified, together with an assessment of the adequacy of controls in place to manage these risks.

5. Monthly reporting by heads of business units to Managing Committee assessing whether risks to their operation are being effectively managed. This includes identifying new risks or those risks where there is an increased likelihood that they will materialise, together with specifying actions required to ensure all risks will be effectively managed. This process is facilitated by the maintenance of exception logs, which identify control weaknesses and resultant actions to improve controls. Key exceptions are documented in a regular report for Managing Committee, together with statistics showing the number of exceptions by department.

6. Creation of a Risk Management Unit to expand the DMO's capability for risk reporting and the management of market and credit risk. Additional staff have been recruited to the Risk Management Unit during the second half of the financial year.

7. Raising awareness of risk in the Office. This includes inclusion of key risks within individual job descriptions and presentations to all staff on the DMO's risk management framework.

8. An enhanced mechanism for prioritising the DMO's programme of projects by Managing Committee and tracking and reporting progress. This has improved Managing Committee's ability to monitor progress and make decisions concerning the allocation of project resources. In addition, additional processes and controls have been introduced at individual project level and further enhancements will continue to be made for managing projects.

9. Establishment of business objectives supported by regular review of business priorities and targets. Work is continuing to develop and refine performance indicators and monitoring capabilities.

10. Production of procedure and control manuals covering the DMO's key operational activities, including all market operations. Further work is continuing to ensure manuals will also be available for all support operations.

11. Business continuity plans, including a disaster recovery site, to be activated in the event of any unanticipated hindrance to the DMO's ability to meet its objectives. The plans and the facilities available at the disaster recovery site are to be updated and tested during the coming year.

My review of the effectiveness of the system of internal control is informed by the work of the internal auditor and management within the DMO who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports.

MIKE WILLIAMS
Chief Executive and DMA Accounting Officer
12 December 2001

The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements 18 to 28 under Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998). These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain investments and the accounting policies set out on pages 21 to 22.

Respective responsibilities of the Agency, Chief Executive and Auditor

As described on page 13 the Agency and Chief Executive are responsible for the preparation of the financial statements in accordance with Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998) and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Agency and Chief Executive are also responsible for the preparation of the other contents of the report. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements give a true and fair view and are properly presented in accordance with Schedule 5A of the National Loans Act 1968 (as amended by the Finance Act 1998) and Treasury directions made thereunder, and whether in all material respects the expenditure and income have been applied to the purpose intended by Parliament and the financial transactions conform to the authorities which govern them. I also report if, in my opinion, the Foreword is not consistent with the financial statements, if the Agency has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I read the other information contained in the report, and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

I review whether the statement on pages 14 to 15 reflects the Agency's compliance with Treasury's guidance "Corporate Governance: Statement on Internal Control". I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements.

Basis of Opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Agency and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Agency's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity and that, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion:

- The financial statements give a true and fair view of the state of affairs of the Debt Management Account at 31 March 2001 and the surplus and cash flows for the period then ended and have been properly prepared in accordance with Schedule 5A to the National Loans Act 1968 (as amended by the Finance Act 1998) and directions made thereunder by HM Treasury; and

- In all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General
13 December 2001

National Audit Office
157-197 Buckingham Palace Road
LONDON
SW1W 9SP

Income and Expenditure Account

Period beginning 15 November 1999 and ending 31 March 2001

	Notes	£m
Interest receivable	2	3,198
Interest payable	3	(3,111)
Net interest revenue		**87**
Dealing profits	4	77
Operating surplus (payable to NLF)	5,13	**164**

All income and expenditure arose from continuing operations.

No separate statement of total recognised gains and losses has been prepared, as there are no recognised gains and losses other than those included in the profit above.

The notes on pages 21 to 28 form part of these accounts.

Balance Sheet

At 31 March 2001

	Notes	£m
ASSETS		
Cash and balances at central banks	8	446
Items in the course of collection from banks		597
Loans and advances to banks	9	12,589
Debt securities	10	9,966
Other assets: prepayments and accrued income	6	460
Total assets		**24,058**
LIABILITIES		
Items in the course of transmission to banks		120
Deposits by banks	11	3,013
Debt securities in issue	12	8,096
Other liabilities: accruals and deferred income	7	224
National Loans Fund – net financing	14	12,441
National Loans Fund – DMA surplus	13	164
Total liabilities		**24,058**

The notes on pages 21 to 28 form part of these accounts.

Cash Flow Statement

Period beginning 15 November 1999 and ending 31 March 2001

	Note	£m
Net cash outflow from operating activities	15(i)	**(11,087)**
Returns on investment and the servicing of finance	15(ii)	(908)
Net cash outflow before financing		**(11,995)**
Financing	15(iii)	12,441
Increase in cash and cash equivalents in the period	15(iv)	**446**

The notes on pages 21 to 28 form part of these accounts.

Notes to the Accounts
for period ended 31 March 2001

1. Accounting Policies

(i) Accounting convention

The accounts have been prepared under the historical cost convention modified by the inclusion of certain investments at valuation. The DMA's financial statements have been prepared in accordance with the DMA accounts direction as issued by HM Treasury. Although the DMA's financial statements are not subject to the requirements of the Companies Acts, and are not technically those of a bank, they have also been prepared in accordance with the provisions of Schedule 9 of the Companies Act 1985 where relevant and in accordance with applicable Accounting Standards and Statements of Recommended Practice in so far as they are appropriate to the DMA.

(ii) Valuation of securities (treasury bills, gilts and other debt securities)

All securities held by the DMA as investments are included in the balance sheet at their market value.

Treasury bills issued by the DMA are included in the balance sheet at their issue price as adjusted to take account of the amount of discount amortised on these securities as at the balance sheet date.

(iii) Sale and repurchase transactions (repos and reverse repos)

Securities, which have been sold with an agreement to repurchase (repo), continue to be shown on the balance sheet and the sale proceeds recorded as a deposit. Securities acquired in reverse sale and repurchase transactions are not recognised in the balance sheet and their 'purchase' price is treated as a loan receivable. The difference between the sale price and repurchase price is accrued evenly over the life of the transaction and charged or credited to the operating statement as interest payable or receivable.

(iv) Gains and losses on trading operations

Gains and losses on trading activities are calculated as the difference between sale proceeds (net of interest) being applied against the cost of each stock (calculated on a 'first in first out' basis). Transaction related costs are not applied to recognised gains and losses on trading as these are accounted for separately through the DMO's agency accounts.

(v) Income recognition

Income is recognised within the accounts on the following basis:

- Realised gains and losses on trading activities are taken to the income and expenditure account in the period in which they arise.
- Gains and losses arising on the repurchase or early settlement of DMA issued Treasury bills are recognised in the income and expenditure account in the period during which the repurchase or early settlement is made.
- Valuation gains and losses on dealing securities are treated on par with realised gains and losses arising and are recognised through the income and expenditure account as part of dealing profits (losses) and included within the carrying value of those securities.

(vi) Administration expenditure

The accounts reflect the activity through, and the financial position of, the DMA. The DMA primarily represents a fund through which the DMO's cash and debt management operational trading activities pass. Administration and staffing costs together with direct trading related costs such as auction costs and stock exchange listing fees are not accounted for through the accounts of the DMA, but instead are shown in the DMO's agency accounts which are audited and published seperately. On this basis the DMA's income and expenditure account only shows stock related gains, deficits and other movements, and associated costs of financing.

(vii) Funding related costs

Funding provided by the National Loans Fund (NLF 'advance') to the DMA is subject to a cost of capital charge. The interest rate applied on the outstanding advance from the NLF is based on the Bank of England's repo rate. The interest rate applied to the DMA's deposit with the NLF is also based on this repo rate.

2. Interest Receivable

	£m	£m
Debt securities		
Gilt-edged securities	576	
Other securities	41	
		617
National Loans Fund – deposit		1,468
Other interest receivable		
Reverse sale and repurchase transactions	1,099	
Deposits with banks	14	
		1,113
		3,198

3. Interest payable

	£m	£m
Discounts on the issue of Treasury bills		350
National Loans Fund – advance		2,453
Other interest payable		
Sale and repurchase transactions	303	
Deposits by banks	2	
Other interest	3	
		308
		3,111

4. Dealing Profits

All dealing profits in the period are from gilt-edged securities

5. Segmental Analysis of Operating Surplus

	TOTAL £m	Cash Management £m	Debt Management £m	NLF & Bank of England £m
Gilt-edged securities	576	520	56	–
Discounts on the issue of Treasury bills	41	41	–	–
National Loans Fund – deposit	1,468	–	–	1,468
Reverse sale and repurchase transactions	1,099	1,098	1	–
Deposits with banks	14	2	–	12
TOTAL INTEREST RECEIVABLE	**3,198**	**1,661**	**57**	**1,480**
Discounts on the issue of Treasury bills	(350)	(350)	–	–
National Loans Fund – advance	(2,453)	–	–	(2,453)
Sale and repurchase transactions	(303)	(303)	–	–
Deposits by banks	(2)	(2)	–	–
Other interest	(3)	(3)	–	–
TOTAL INTEREST PAYABLE	**(3,111)**	**(658)**	**–**	**(2,453)**
NET INTEREST REVENUE / (EXPENSE)	**87**	**1,003**	**57**	**(973)**
Dealing profits	77			
NET OPERATING GAIN	**164**			

6. Other Assets: Prepayments and accrued income

	£m
Accrued coupon interest	142
Accrued interest on NLF deposit	137
Accrued interest on reverse repos	180
Accrued interest on bank deposit	1
	460

7. Other Liabilities: Accruals and deferred income

	£m
Accrued interest – repos/borrowings	9
Accrued interest – NLF advance	215
	224

8. Cash and balances at central banks

	£m
DMA bank balance at the Bank of England	446
	446

9. Loans and advances to banks

	£m
Loans and advances – remaining maturity	
3 months or less	10,988
1 year or less but over 3 months	1,601
	12,589

Loans of £12,589m are secured with government and supranational securities under sale and repurchase agreements.

10. Debt Securities

Debt securities (at market value)	**£m**
British government securities – gilts	7,363
Other securities	2,603
	9,966

Maturity Analysis	Nominal £m	Market Value £m	Balance Sheet Value £m
Securities by remaining maturity			
In not more than three months	2,575	2,573	2,573
In more than three months but not more than one year	1,281	1,498	1,498
In more than one year but not more than five years	1,670	1,812	1,812
In more than five years	3,245	4,083	4,083
	8,771	**9,966**	**9,966**

11. Deposits by banks

All deposits by banks at the 31 March 2001 (totalling £3,013m) related to repo transactions secured by marketable securities. All deposits by banks had a maturity of 3 months or less, but none were repayable on demand.

Securities that have been 'sold' with an agreement to repurchase (repo) continue to be shown within stock totals.

The market value of securities used to secure the deposits by banks was £3,088m (nominal value £2,495m) at the balance sheet date.

12. Debt securities in issue

Treasury bills with a book value of £8,096m (market value of £8,093m) were in issue at the balance sheet date. All Treasury bills in issue had a remaining maturity of 3 months or less.

13. National Loans Fund – DMA Surplus

	£m
At 15 November 1999	–
DMA surplus in period	164
Surplus paid to NLF in period	–
At 31 March 2001	**164**

DMA operating surpluses and deficits are an asset or liability of the NLF respectively. All or part of any DMA surplus created may be paid to the NLF, which will accordingly reduce the liability of the DMA to the NLF.

14. NLF Advance and Deposit

	NLF Deposit £m	NLF Advance £m	Net NLF Financing £m
Aggregate advance from NLF to DMA	–	(55,000)	(55,000)
Aggregate repayments of NLF advance by DMA	–	20,000	20,000
Net Change in DMA Deposit with NLF	22,559	–	22,559
Balance carried forward at 31 March 2001	**22,559**	**(35,000)**	**(12,441)**

15. Cash Flow Statement

(i) Reconcilliation of operating surplus to net cash outflow from operating activities

	£m
Operating surplus	**164**
Servicing of finance added back	908
Increase in accrued interest receivable	(460)
Increase in accrued interest payable	224
Increase in items in the course of collection	(597)
Increase in items in the course of transmission	120
Increase in gilts and other securities	(9,966)
Increase in loans and advances to banks (including reverse repo)	(12,589)
Increase in deposits by banks (including repo)	3,013
Increase in Treasury bills issue	8,096
	(11,251)
Net cash outflow from operating activities	**(11,087)**

(ii) Returns on investment and the servicing of finance

Interest on NLF advance	(2,238)
Interest on NLF deposit	1,330
	(908)

(iii) Analysis of changes in financing during the year

Net increase in advance from the National Loans Fund	35,000
Net increase in deposit from the National Loans Fund	(22,559)
	12,441

(iv) Analysis of the balances of cash as shown in the balance sheet

	At 15 November 1999	Cash inflow	At 31 March 2001
Cash and balances at the Bank of England	–	446	446

16. Related party transactions

HM Treasury

The DMO is an Executive Agency of HM Treasury; activities through the DMA therefore are undertaken on behalf of HM Treasury. HM Treasury and the DMO are therefore related parties.

The main services provided to the HM Treasury during the year were:

Debt Management, including the management of auctions and taps for the issue of gilt edged securities on behalf of the National Loans Fund and market making operations.

Cash management, including responsibility for the issue and redemption of Treasury bills.

The buying and selling of non-marketable NILO stocks on behalf of the Commissioners for the Reduction of the National Debt regarding their management of National Debt Office funds.

In turn HM Treasury has provided the following services to the DMO, which have been funded through the HM Treasury vote relating to DMO administration expenditure, and accounted through the DMO Agency accounts;

Payroll, purchasing and various administrative services.

Bank of England

The DMO relies upon the Bank of England's settlement system for the processing of settlement amounts on trading activity and the maintenance of the DMA's bank accounts.

DMO Managing Committee

Members of the DMO’s Managing Committee have had no personal interest in transactions through the DMA.

Accounts Direction given by HM Treasury under the National Loans Act 1968[1]

1. The Treasury shall prepare accounts for the Debt Management Account ("the Account") for the period ending 31 March 2001 and each subsequent financial year comprising:

   (a) A foreword
   (b) A statement of Accounting Officer's responsibilities
   (c) A statement on the system of internal financial control[2]
   (d) An income and expenditure account
   (e) A statement of total recognised gains and losses
   (f) A balance sheet
   (g) A cash flow statement
   (h) Notes to the accounts

2. The accounts shall give a true and fair view of the state of affairs of the Account at the balance sheet date and of its income and expenditure, total recognised gains and losses and cash flows for the year then ended. The accounts shall be prepared under the historical cost convention modified to include certain investments at valuation and in accordance with applicable accounting standards and where appropriate, although not subject to the Companies Act and technically not being the accounts of a bank, the special provisions of Schedule 9 of the Companies Act 1985 relating to banking companies and the Statements of Recommended Practice issued by the British Bankers' Association and the Irish Bankers' Federation.

3. The accounts shall also be consistent with relevant requirements of the Resource Accounting Manual, except to the extent set out in Appendix A and shall meet the extra information requirements set out in Appendix B.

4. This Accounts Direction shall be reproduced as an Appendix to the Accounts.

David Loweth
Head of Central Accountancy Team
HM Treasury
11 December 2001

1 As amended by the Finance Act 1998
2 From 2001-02, a statement on the system of internal control

Appendix A

APPLICATION OF THE RESOURCE ACCOUNTING MANUAL

Background

1. The Debt Management Account reflects activity that more closely resembles that of a bank than that of an entity covered by the Resource Accounting Manual (RAM). Accordingly, an income and expenditure account shall be prepared instead of Schedule 2, the operating cost statement, and both it and the balance sheet shall be prepared in the same format as those required by Schedule 9 of the Companies Act 1985. Schedule 1 – Summary of Resource Outturn, and Schedule 5 – Resources by Departmental Aim and Objective, are also not relevant.

2. In other respects, the accounts shall be consistent with relevant requirements of the RAM except in so far as is necessary to reflect the special requirements stated below.

Income and expenditure account

3. Segmental information shall be given where appropriate, including of separate classes of business.

Balance sheet

4. Subject to paragraphs 5 to 7 below, investments shall be valued at market price or at an appropriate estimate of market or fair value.

5. Interests in securities maintained for the purposes of hedging shall be carried at a value that properly reflects the hedge.

6. Investment securities, being securities held for use on a continuing basis in the activities in the Account, shall be carried at cost as adjusted for:

   a. the amortisation of the premium or discount representing the premium or discount between cost and the redemption proceeds, for redeemable securities;
   b. any diminution in their value that is expected to be other than temporary;
   c. translation differences where the investment securities are denominated in foreign currencies.

7. Advances and loans shall be carried at cost less appropriate provision for doubtful debts.

8. All movements in values of investments shall be reflected in the income and expenditure account, including translation differences arising in relation to investment securities denominated in foreign currencies.

Cash Flow Statement

9. The return on investments and servicing of finance will form a separate line in the cash flow statement.

Appendix B

EXTRA INFORMATION REQUIRED TO BE DISCLOSED

1. In addition to meeting appropriate requirements of the Companies Act, the banking SORPs and the Resource Accounting Manual, the following extra information shall be disclosed, including in order to facilitate the preparation and consistency of Whole of Government Accounts.

Foreword

2. The foreword shall include:

   a. A brief history of the Account, and its statutory background;
   b. An outline of the scope of the Account, its status in relation to HM Treasury and other central funds, and its management arrangements;
   c. An operating and financial review;
      i) meeting relevant requirements of the Accounting Standards Board's Statement and the narrative disclosure requirements of FRS 13, "Derivatives and other financial instruments – disclosures" for banks and similar institutions; and
      ii) including appropriate information on financial performance and position reflecting the relationship between the Account and other relevant central funds, and information on targets set by HM Treasury and their achievement.

Notes to the accounts

3. The notes to the accounts shall include the following:

   a. Analyses of assets, between fixed and current assets;
   b. Analyses of debtors and creditors, between those falling due within and after one year;
   c. Where not separately disclosed on the face of the income and expenditure accounts, analyses of income and expenditure giving totals for the following;
      i) Interest receivable and similar income
      ii) Interest payable and similar charges
      iii) Other operating income, including income derived from the provision of services
      iv) Operating costs
   d. Disclosure of income and expenditure, and assets and liabilities, relating to other central government funds, including the National Loans Fund, including analyses by funding purpose;
   e. Disclosures meeting the requirements of FRS 13, "Derivatives and other financial instruments – disclosures" as applying to banks and similar institutions, including numerical disclosures about interest risk, currency risk, fair values, and financial instruments used for trading (including information on the market price risk of the trading book).

Printed in the UK for the Stationery Office Limited
On behalf of the Controller of Her Majesty's Stationery Office
ID 77590 12/01